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No. 379

In the Supreme Court of the United States

OCTOBER TERM, 1957

EARL J. CARROLL, PETITIONER,

v.

UNITED STATES

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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BRIEF FOR THE UNITED STATES IN OPPOSITION

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OPINIONS BELOW

The opinion of the District Court (Pet. 21-26) is reported at 149 F. Supp. 634. The opinion of the Court of Appeals (Pet. 27-34) is not yet reported.

JURISDICTION

The judgment of the Court of Appeals was entered on July 8, 1957. (Pet. 35.) The petition for a writ of certiorari was filed on August 17, 1957. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether the courts below correctly concluded that a determination that taxpayer was not a bona fide resident of a foreign country during the taxable years in question was not a condition precedent to investigation of his tax liability for that period.

STATUTES INVOLVED

Internal Revenue Code of 1939:

SEC. 116. EXCLUSIONS FROM GROSS INCOME.

In addition to the items specified in section 22 (b), the following items shall not be included in gross income and shall be exempt from taxation under this chapter:

(a) [As amended by Sec. 148(a), Revenue Act of 1942, c. 619, 56 Stat. 798; Sec. 107(b), Revenue Act of 1943, c. 63, 58 Stat. 21; Sec. 321(a), Revenue Act of 1951, c. 521, 65 Stat. 452] *Earned Income from Sources Without the United States.*—

(1) *Bona fide resident of foreign country.*—In the case of an individual citizen of the United States, who establishes to the satisfaction of the Secretary that he has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof) if such amounts constitute earned income (as defined in paragraph (3)) attributable to such period; but such individual shall not be allowed as a deduction from his gross

income any deductions properly allocable to or chargeable against amounts excluded from gross income under this paragraph.

* * * *

(3) *Definition of earned income.*—For the purposes of this subsection, "earned income" means wages, salaries, professional fees, and other amounts received as compensation for personal services actually rendered, but does not include that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered. In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income producing factors, under regulations prescribed by the Commissioner with the approval of the Secretary, a reasonable allowance as compensation for the personal services rendered by the taxpayer, not in excess of 20 per centum of his share of the net profits of such trade or business, shall be considered as earned income.

* * * *

(26 U.S.C. 1952 ed., Sec. 116.)

The provisions of the Internal Revenue Code of 1954, Section 911(a)(1) and (b), (26 U.S.C. 1952 ed., Supp. II, Sec. 911) are substantially the same.

Internal Revenue Code of 1954:

SEC. 7601. CANVASS OF DISTRICTS FOR TAXABLE PERSONS AND OBJECTS.

(a) *General Rule.*—The Secretary or his delegate shall, to the extent he deems it practicable,

cause officers or employees of the Treasury Department to proceed, from time to time, through each internal revenue district and inquire after and concerning all persons therein who may be liable to pay any internal revenue tax, and all persons owning or having the care and management of any objects with respect to which any tax is imposed.

* * * *

(26 U.S.C. 1952 ed., Supp. II, Sec. 7601.)

SEC. 7602. EXAMINATION OF BOOKS AND WITNESSES.

For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary or his delegate is authorized—

(1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;

(2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary or his delegate may deem proper, to appear before the Secretary or his delegate at a time and place named in the summons and to produce such books,

papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry * * *.

(26 U.S.C. 1952 ed., Supp. II, Sec. 7602.)

SEC. 7604. ENFORCEMENT OF SUMMONS.

(a) *Jurisdiction of District Court.*—If any person is summoned under the internal revenue laws to appear, to testify, or to produce books, papers, records, or other data, the United States district court for the district in which such person resides or is found shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, records, or other data.

(b) *Enforcement.*—Whenever any person summoned under section 7602 neglects or refuses to obey such summons, or to produce books, papers, records, or other data, or to give testimony, as required, the Secretary or his delegate may apply to the judge of the district court or to a United States commissioner for the district within which the person so summoned resides or is found for an attachment against him as for a contempt. It shall be the duty of the judge or commissioner to hear the application, and, if satisfactory proof is made, to issue an attachment, directed to some proper officer, for the arrest of such person, and upon his being brought before him to proceed to a hearing of the case; and upon such hearing the judge or the United States commissioner shall have power to make such order as he shall deem proper, not inconsistent with the law for the punishment of contempts, to enforce obedience to the require-

ments of the summons and to punish such person for his default or disobedience.

* * * *

(26 U.S.C. 1952 ed., Supp. II, Sec. 7604.)

SEC. 7605. TIME AND PLACE OF EXAMINATION.

* * * *

(b) *Restrictions on Examination of Taxpayer.*—No taxpayer shall be subjected to unnecessary examination or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Secretary or his delegate, after investigation, notifies the taxpayer in writing that an additional inspection is necessary.

(26 U.S.C. 1952 ed., Supp. II, Sec. 7605.)

STATEMENT

Earl J. Carroll, hereafter referred to as the taxpayer, is an American citizen and a member of the California Bar. He served as an Air Force officer during World War II, part of his duties involving legal work in Germany. After discharge from the service, he, in November, 1946, returned to Europe. From 1946 to 1954, inclusive, comprising most of the taxable period here involved, he practiced law in Germany, numbering among his clients Alfred Krupp von Bohlen and Halbach, and Frederick Flick, the German industrialists. Although he admitted having received income from his foreign endeavors—the Court of Appeals concluded (Pet. 28) that "He may have earned a substantial amount of money from his

practice"—he did not report this in the returns which he filed for the period in question. (R. 14a-17a, 24a, 31a, 32a, 69a, 87a.)[1]

Pursuant to the provisions of Section 7601 of the Internal Revenue Code of 1954, *supra*, the Treasury Department began an inquiry into the taxpayer's liability. (R. 8a, 86a.) On December 6, 1955, agents of the Internal Revenue Service, pursuant to the provisions of Section 7602 of the Internal Revenue Code of 1954, summoned taxpayer to appear and give testimony relating to his tax liability for the period 1944 to 1954, inclusive, and to bring with him and produce for examination (R. 9a-10a):

> All books, records, cancelled checks, memoranda and papers of whatsoever kind or nature pertaining to income or monies received, accrued or credited to your account during the years shown above; including specifically the following: (1) Information relating to amounts received and disbursed in the Krupp and Flick matters; (2) Information relating to court martial and all other fees received by you during the years shown; and, (3) The dates on which you arrived in and departed from the United States (and foreign countries) for the years shown.

At hearings on August 16 and 17, 1956, the taxpayer testified at length as to his residence abroad. He failed, however, to produce any of the requested documentary material, and he refused to answer questions concerning his contractual and financial re-

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[1] References designated "R." are to the appendix to petitioner's brief in the Court of Appeals.

lations with Krupp and Flick and to give any information concerning other income earned in Germany or other foreign countries during the period in question. His refusal was based on his allegation that he had conclusively demonstrated that during that period he was a bona fide resident of a foreign country. Allegedly, therefore, under the provisions of Section 116(a)(1) of the Internal Revenue Code of 1939 and Section 911(a)(1) of the Internal Revenue Code of 1954, any income which he had earned abroad was not taxable income, thus rendering any investigation of his foreign earnings "unnecessary" within the meaning of Section 7605(b) of the Internal Revenue Code of 1954. (R. 6a, Pet. 28-30.)

Subsequently, on *ex parte* application for enforcement of the summons made pursuant to the provisions of Section 7604 of the Internal Revenue Code of 1954, the United States District Court for the Southern District of New York entered an order on August 22, 1956, requiring the taxpayer to comply with the summons. The taxpayer thereupon moved to vacate the order. The motion was denied. An appeal was taken from the order denying the motion to vacate. The Court of Appeals affirmed the order of the District Court. (R. 2a, Pet. 30, 35.)

ARGUMENT

1. In holding that the taxpayer was required to testify and produce records concerning income earned but admittedly not reported during the period 1944 through 1954—without prior resolution of the claimed defense that such income was exempt from taxation

by virtue of the taxpayer's alleged foreign residence—the decision below correctly enforces the investigatory authority conferred by Section 7602 of the Internal Revenue Code of 1954, *supra*. That section in part provides that, for the purpose of ascertaining the correctness of any return or determining the tax liability of any person, the Secretary or his delegate is authorized to summon the person liable for tax to give such testimony and to produce for examination such documentary material as may be relevant or material to the investigation. The right to investigate—a corollary of the duty which Congress has imposed upon the Treasury Department (Section 7601(a) of the Internal Revenue Code of 1954, *supra*)—has been broadly construed. Cf. *Civil Aeronautics Board* v. *Hermann*, 353 U. S. 322; see also *Falsone* v. *United States*, 205 F. 2d 734, 742 (C. A. 5th), certiorari denied, 346 U. S. 864. The only statutory restrictions are (1) that no taxpayer shall be subjected to "unnecessary examination or investigations," and (2) that except upon the taxpayer's request or upon written notice given by the Secretary, "only one inspection of a taxpayer's books of account shall be made for each taxable year." Section 7605(b) of the Internal Revenue Code of 1954, *supra*.

The taxpayer has not contended below, nor does he now contend, that the information and material sought to be obtained through the summons proceeding are not germane to an investigation of his tax liability, if the income which is the subject of the investigation is taxable. The substance of his posi-

tion is that all inquiry into the nature and amount of that income is foreclosed simply because, having (Pet. 9) allegedly "clearly demonstrated that he was * * * a bona fide foreign resident," the income sought to be determined was in any event exempt, and it would therefore follow that any inquiry concerning it would be "unnecessary" under Section 7605(b) and would constitute (Pet. 10) "an unreasonable search condemned by the Fourth Amendment." The basic fallacy of his position lies in the underlying assumptions (a) that resolution of the residence issue was a condition precedent to the investigative function; and (b) that the taxpayer had conclusively demonstrated in the District Court proceedings that during the taxable period he was a bona fide resident within the meaning of the exemption provisions of the 1939 and 1954 Codes.

(a) As to the first assumption, the short answer is that even if the taxpayer was a bona fide foreign resident, only "earned income" is exempt under the Code provisions.[2] Accordingly, the Government is entitled to inquire into the source of income, in order to determine whether the taxpayer's income included amounts received other than by way of compensation for services; for example, whether the taxpayer had received fees in property rather than in cash, in which event any gain realized in turn from such property would not be earned income within the meaning of the exemption provisions. The Govern-

[2] Section 116(a) of the 1939 Code, *supra*, and Section 911(a) of the 1954 Code, *supra*.

ment is also entitled to inquire whether any part of the fees received was for work done in the United States, in which event the compensation for such work would be taxable.

Furthermore, in ascertaining whether compliance with the provisions of the summons was required on the basis of the pleadings and affidavits before it, it is questionable whether the District Court could decide the issue of foreign residence so as to determine whether or not an assessment should be made against the taxpayer. Cf. *Endicott Johnson Corp.* v. *Perkins*, 317 U. S. 501; *Okla. Press Pub. Co.* v. *Walling*, 327 U. S. 186. Inquiry into possible tax liability is not a judicial proceeding where rights are finally determined; it is plainly inquisitorial in nature (*Faisone* v. *United States, supra*, p. 737; *In re Wood*, 123 F. Supp. 297, 302 (W.D. Ky.); *Torras* v. *Stradley*, 103 F. Supp. 737, 739 (N.D. Ga.); *Bolich* v. *Rubel*, 67 F. 2d 894, 895 (C.A. 2d)) and, in a sense, is analogous to the power vested in federal grand juries, which are not required to hear and decide the defenses of a prospective defendant (*Falsone* v. *United States, supra*, p. 737). As stated by the District Court (Pet. 24): "The issue of bona fide foreign residence may, in due course, reach the court in a suit for a refund, but the court may not short circuit the procedure by usurping the administrative function."

And finally, as the Government alleged (R. 87a-88a), and as both courts below apparently agreed (Pet. 26, 34), the information and materials sought to be obtained by the summons procedure were not only relevant to a determination of the taxpayer's

income, but to resolution of the residence question as well. As the court below stated (Pet. 34):

> No one can tell until after the event, and the examination of the taxpayer has been concluded, what may or may not be the interrelation between these seemingly separate and distinct matters. Indeed, although the kind of legal work which petitioner did during these years, for whom, how much and on what basis he was paid, how he was paid and when, may all seem to bear largely on the amount of his income, it cannot be said that such information regarding the activities of a professional man are irrelevant to the question of his residence.

To hold, therefore, that determination of the residence issue was a prerequisite to investigation would defeat the statutory purpose of inquiring "after * * * all persons * * * who may be liable to pay any internal revenue tax" (Section 7601 of the 1954 Code, *supra*) just as much as would obviously be the case if, in a situation involving only income earned in the United States, a taxpayer, upon denial of liability, could require the Government to prove tax liability in advance of any investigation. As the Court of Appeals observed (Pet. 33-34)—

> Were we to hold otherwise we would permit the taxpayer to control the course of the investigation and deprive the Government of the legitimate and wholly desirable advantage, which may well prove decisive in particular cases, of pursuing *pari passu* the issues relating to earnings and income on the one hand and to residence abroad on the other.

(b) As to the second assumption underlying the taxpayer's position—that he had conclusively demonstrated that he was a bona fide resident of a foreign country during the taxable period—the fact is that the District Court had before it the affidavit of an appropriate official of the Internal Revenue Service, casting serious doubt upon the correctness of the taxpayer's allegation of foreign residence, and concluding that there were "reasonable grounds to believe * * * that Mr. Carroll was not a bona-fide resident of a foreign country or countries during the years in question * * *."[3] Even if it is assumed, *arguendo*, that the taxpayer's proof of foreign residence required contravention, the affidavit submitted on behalf of the Government, alleging that there were reasonable grounds to believe that the taxpayer was not a bona fide foreign resident within the meaning of the exemption provisions, was sufficient to demonstrate "reasonable grounds for a suspicion" that the alleged defense was without substance. *Corbin Deposit Bank* v. *United States*, 244 F. 2d 177 (C. A. 6th).[4] To require greater specificity—or as the taxpayer contends, the very litigation of the issue—"would virtually nullify the investigative powers

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[3] See Paragraphs 6 and 8 of the affidavit of Bernard V. Roberts. (R. 87a-88a).

[4] See also *Globe Construction Co.* v. *Humphrey*, 229 F. 2d 148 (C. A. 5th); *United States* v. *United Distillers Products Corp.*, 156 F. 2d 872, 874 (C. A. 2d); *Application of Levine*, 149 F. Supp. 642 (S.D. N.Y.), affirmed *per curiam*, 243 F. 2d 175 (C. A. 2d); *Zimmermann* v. *Wilson*, 105 F. 2d 583, 586 (C. A. 3d).

enumerated in §§ 7601 through 7607 of the Internal Revenue Code of 1954." (*Id.* at p. 178.) See also *Globe Construction Co.* v. *Humphrey*, 229 F. 2d 148 (C. A. 5th); *Peoples Deposit Bank & Trust Co.* v. *United States*, 212 F. 2d 86 (C. A. 6th).

2. There is no conflict of decisions. The alleged conflict with decisions of the Third and Ninth Circuits (Pet. 12) is admittedly based on the taxpayer's hypothesis (Pet. 13) that the instant case "conflicts with the settled rule that a showing of the reasonableness and necessity for the examination must be made by the Government." But such a showing was made here; as indicated above, the information and documentary material sought to be obtained through the summons proceeding were alleged by the Government, and were considered by both courts below, to be relevant not only to a determination of admittedly unreported income but also to a determination of the foreign residence issue. In fact, the District Court concluded that (Pet. 22)—

> Without more, it is apparent from the face of the complaint that the information sought is relevant to the inquiry concerning persons who may be liable to pay an internal revenue tax, or that it bears upon matters required to be included in a return, and by the very nature of the information required it does not appear to be unnecessary.

Clearly, the investigation was not "out of proportion to the end sought," and no constitutional violation was involved in enforcing the summons. *Zimmermann* v. *Wilson*, 105 F. 2d 583, 585 (C. A. 3d).

In any event, the cases alleged to be in conflict with the instant case (Pet. 12) do not support the taxpayer's position. In *Local 174, Etc.* v. *United States*, 240 F. 2d 387 (C. A. 9th), the court found that, in connection with the investigation of the tax liability of a union official and his wife, the subpoena in question (p. 391) "asked for a general search of the papers and documents of the Local" and that there had been "obviously no attempt to confine the demand to items which might be relevant or material to the taxes of the Brewsters." The factual situation in the instant case is quite different; the summons called for the *taxpayer's* records, which were so described therein as to make it patent that they were germane to an investigation of his liability. *Boren* v. *Tucker*, 239 F. 2d 767 (C.A. 9th), upon analysis, supports the decision below. In affirming a contempt judgment for refusing to produce corporate books and records sought to be examined in connection with an investigation of the liability of two of its officers, the court—observing that (p. 773) "Any issue of proof of actual fraud must of necessity await trial; and may never ultimately be alleged"—concluded that the special agent had made (p. 774) "a sufficient showing of the possibility of fraud to permit the enquiry into the matter * * *." In *Martin* v. *Chandis Securities Co.*, 128 F. 2d 731 (C. A. 9th), also involving a proposed examination of third party records, the court found that the Government's petition to enforce the summons, where the statute of limitations had run against assessment, had (p. 733) "stated no reason for examination of the requested records," and

that it had not been (p. 735) "stated anywhere specifically that * * * [the Government's] representatives had a 'reasonable ground' to entertain * * * suspicion" of fraud. The court explicitly accepted as the appropriate test that (p. 735) "the only showing required (and we assume also that the only allegation required) is a 'showing of probable cause, sometimes called reasonable ground for suspicion of fraud.'" Finally, *Zimmermann* v. *Wilson*, 105 F. 2d 583 (C. A. 3d), is also in accord with the decision below. In holding that the Government was entitled to examine certain third party records after the running of the statute of limitations on assessment against the taxpayer, the Third Circuit approved the proposition that (p. 586) "actual proof of fraud was not necessary, but that a showing of reasonable ground of 'suspicion of fraud' was enough"; that it was (p. 585) "not unreasonable to allow the Government to obtain all available information"; and that the "question of whether fraud is established * * * is not before us * * * [since the investigating authorities are] merely seeking further information."

As for the two decisions of this Court with which the taxpayer generally asserts conflict[5] (Pet. 8), they do not involve statutory provisions, questions, or facts similar to those here involved. Indeed, insofar as they may be deemed relevant, they support the decision below.

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[5] *Hale* v. *Henkel*, 201 U.S. 43; *Federal Trade Commission* v. *American Tobacco Company*, 264 U.S. 298.

CONCLUSION

The decision of the court below is correct, there are no conflicting decisions, and further review is not warranted. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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